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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY, *Petitioner,*

vs.

GUY T. HELVERING, Commissioner of Internal Revenue, *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF OF PETITIONER

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BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13) is reported in 34 B. T. A. 145.

The opinion of the Circuit Court of Appeals (R. 36) is reported in 89 Fed. (2d) 711.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 8, 1937 (R. 42). The petition for writ of certiorari was filed June 2, 1937, and was granted October 11,

1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT OF THE CASE

On August 23, 1928, pursuant to a plan of statutory reorganization (see *Helvering v. Minnesota Tea Co.*, 296 U. S. 378; *Minnesota Tea Co. v. Commissioner*, 76 F. (2d) 797), Minnesota Tea Company transferred all its property to the Grand Union Company, in exchange for 18,000 shares of the common stock (voting trust certificates) of the latter company, plus $426,842.52 in cash. Pursuant to the plan of reorganization, Minnesota Tea Company thereupon distributed all the cash to its stockholders, who assumed and agreed to pay, and later actually paid, liabilities of the petitioner to the extent of $106,471.73.

The resolution of the stockholders of the petitioner under which the cash was distributed is as follows:

> "Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders, whereby said stock-

holders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of Minnesota Tea Company whether due and payable or not and whether certain or contingent." (R. 28).

In his notice of deficiency (R. 7-12) the Commissioner of Internal Revenue proposed a deficiency of $11,587.64, on the theory that to the extent that liabilities of the petitioner had been assumed by the stockholders, the petitioner had not "distributed" the cash within the meaning of Section 112 (d) of the Revenue Act of 1928, and that taxable gain of $106,471.73, the amount of said liabilities, was therefore recognizable and taxable to the petitioner.

The matter was thereupon brought before the Board of Tax Appeals for review, upon the sole issue of whether or not the petitioner realized a taxable gain of $106,471.73 as a result of the transactions above set forth. No contention was made by the Government that the petitioner was taxable upon any greater sum than that amount. The Board of Tax Appeals, however, of its own motion, raised the question as to whether such statutory reorganization had been effected; and, in its decision, held that there was no reorganization, but a sale of assets, and that petitioner was taxable on the gain thereof. The case was then reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, which (76 F. (2d) 797) reversed the Board of Tax Appeals in its conclusion on the reorganization question, and remanded the case to the Board of Tax Appeals for determination of the orginal issue. This Court granted certiorari (296 U. S. 562) on application of the Commissioner of Internal Revenue, and later affirmed the Circuit Court (296

U. S. 378). Upon affirmance by this Court, the Board of Tax Appeals, after a hearing pursuant to the mandate, in an opinion promulgated March 18, 1936, reported in 34 B. T. A. 145, (R. 13) held that the sum of $426,842.52 having been entirely distributed to the shareholders pursuant to the plan of reorganization, and in conformity to the reorganization provisions of the Revenue Act of 1928, no part thereof may be regarded as recognizable gain to the corporation, notwithstanding the assumption by the shareholders of the corporate debts.

Upon petition of the Commissioner of Internal Revenue, the Circuit Court of Appeals reviewed this second decision of the Board of Tax Appeals, and, reversing the Board, held (R. 36) that notwithstanding literal compliance with the statute, the payment of the corporate debts by the stockholders under the circumstances here presented resulted in taxable gain to the corporation, up to $106,471.73, the amount of said debts. Certiorari was granted by this Court October 11, 1937.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1) In holding that it is an exemption from taxation which is claimed by petitioner, and that upon it lies the burden of establishing the right thereto.

2) In failing to hold that it is the Government which claims an exemption from the operation of the statute, and upon it lies the burden of establishing such claim.

3) In holding that payment of the entire amount of cash received by Minnesota Tea Company from Grand Union Company to its stockholders in proportion to their

stockholdings was not a distribution within Sec. 112 (d) (1) of the Revenue Act of 1928.

4) In failing to hold that the transaction here involved constituted a compliance with Sec. 112 (d) (1) and hence that no gain should be recognized to the corporation.

5) In holding that the petitioner did not comply with Sec. 112 (d) (1) of the Revenue Act of 1928.

6) In holding that there was taxable gain to the petitioner by reason of the fact that its stockholders assumed and paid its liabilities.

7) In reversing the decision of the Board of Tax Appeals.

QUESTION PRESENTED

Whether the fact that stockholders assumed and paid certain indebtedness of a corporation upon distribution *pro rata* to the stockholders of all of the cash received by that corporation in a statutory reorganization, renders the corporation subject to tax on a gain, which otherwise would not be recognizable to it under the provisions of Sec. 112 (d) of the Revenue Act of 1928.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix.

ARGUMENT

It is, in effect, admitted by the respondent that the entire sum of $426,842.52, which was received by the petitioner

from the Grand Union Company, was distributed to the stockholders of the petitioner in literal compliance with the statute, Sec. 112 (d) (1), which reads:

> "If the corporation receiving such other property or money distributes it in pursuance of a plan of reorganization, no gain to the corporation shall be recognized from the exchange."

It is, however, the claim of the respondent that since the stockholders to whom the money was in fact distributed assumed and later paid debts of the corporation to the extent of $106,471.73, the latter amount cannot be regarded as having been "distributed" within the meaning of the statute. In other words, it is claimed that the actual distribution was converted to the extent of $106,471.73 into a constructive nondistribution. Accordingly, the respondent seeks to nullify literal compliance with the statute and claims exemption from its operation.

That the reorganization provisions of the Revenue Act do not grant an *exemption* from taxation is made clear in the report of the Ways and Means Committee in 1924 (Rep. No. 179, 68th Cong., 1st Sess., pp. 16-17) when discussing Sec. 203 (which corresponds to Sec. 112 of the 1928 Act), which reads in part as follow:

> "The provisions of Sec. 203 of the bill that no gain or loss is recognized from certain exchanges *do not grant an exemption and are not so intended.* These provisions are based upon the theory that the types of exchanges specified in Sec. 203 are merely changes in form and not in substance, and consequently should not be considered as effecting a realization of income at the time of the exchange. In other words, *these provisions result not in an exemption from tax but in a postponement of tax until the gain is realized by a pure sale or by such an exchange as amounts to a pure sale.* It follows, therefore, that in the case of such an exchange the property received should be considered as

taking the place of the property exchanged. If in connection with the exchange money is received which is not taxed, obviously the basis at which the old property is carried on the books of the taxpayer should be reduced to that extent, since the taxpayer has in part received a return of capital. But if money is received in connection with the exchange and the money is taxed, it is equally obvious that the basis of the old property should not be affected." (Italics Supplied)

We, therefore, say that the Court below is in error when it says in its opinion (R. 38): "It is an exemption from taxation which is here claimed by respondent (petitioner here) and upon it lies the burden of establishing the right thereto." Correctly viewed, it is the respondent here who seeks to depart from a recognition of the facts and to call the actual distribution, which was made in compliance with the statute, a constructive payment of the petitioner's debts by the petitioner itself. The burden, therefore, is not upon the taxpayer to establish its right to exemption, but upon the respondent to establish the Government's right to collect a tax upon the item in question.

While it is probably not a matter of paramount importance to the decision of this case, we submit that the Court below, for the reasons above stated, commences its reasoning with an erroneous premise.

Coming now to the merits of the case, it is the contention of the petitioner that since the entire amount of $426,842.52 received by it in a statutory reorganization was in fact distributed by it through a dividend to its stockholders, pursuant to the plan of reorganization, it not only complied with the literal wording of Sec. 112 (d) (1) of the Revenue Act of 1928, but has complied also with the true meaning and spirit of that section.

The terms of the statute, the terms of the applicable Regulations, the reports of the Committees of Congress and

the statement prepared by the Treasury at the time of enactment of the Revenue Act of 1924 (in which the provisions in question first appeared), all show (see Appendix) that when the cash is distributed to the stockholders pursuant to the plan of reorganization there is an end to the question of any gain being recognized to the company.

It is clear from the reports and statements above mentioned, as well as from the numerous decisions of this Court on the subject, that the dominant purpose of the reorganization statutes was to provide for an exemption from taxation (or, more accurately, a *postponement* of taxation) *at the time of a business reorganization,* of the gains involved therein to the extent specified in the statute, in order (1) to remove impediments to corporate readjustments, and (2) to prevent the recognition of mere paper profits or losses. *U. S. v. Hendler,* C. C. A. 4 (not yet officially reported), 374 C. C. H. Sec. 9448.

This dominant purpose is also shown in the Committee Reports accompanying the various Revenue Acts. Thus, at the time of enactment of the Revenue Act of 1921, which contained the first definition of "reorganization," the Senate Finance Committee reported as follows:

> "Under the existing law 'when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any * * *.' Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments * * *.
>
> "* * * The proposed act * * * specifies * * * certain classes of exchanges on which no gain or loss is recognized * * *.
>
> "The preceding amendments, if adopted, will, *by removing a source of grave uncertainty and by elimi-*

*nating many technical constructions which are economically unsound, * * * permit business to go forward with the adjustments required by existing conditions."* [1] (Italics Supplied)

Again, in reporting the 1924 Revenue Bill, which extended the reorganization provisions to situations not theretofore covered and which provisions were basically the same as those in the 1928 Act here involved, the Senate Finance Committee reported:

"Paragraph (3) provides that no gain or loss is recognized if a corporation a party to a reorganization exchanges property for stock or securities in another corporation a party to the reorganization. There is no corresponding provision of the existing law, although this paragraph embodies the construction placed by the Treasury Department upon the existing law. The present ruling of the Treasury Department on this question is of doubtful legality and a statutory provision is most necessary.

"Congress has heretofore adopted the policy of exempting from tax the gain from exchanges made in connection with a reorganization *in order that ordinary business transactions will not be prevented on account of the provisions of the tax law.* If it is necessary for this reason to exempt from tax the gain realized by the stockholders, it is even more necessary to exempt from tax the gain realized by the corporation." [2] (Italics Supplied)

In connection with the 1924 Bill, the Ways and Means Committee also reported:

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1 Rep. No. 275, 67th Cong., 1st Sess., pp. 11-12. See also Ways and Means Committee Report, Rep. No. 350, 67th Cong., 1st Sess., p. 10.

2 Rep. No. 398, 68th Cong., 1st Sess., pp. 14-15. Similar remarks appear in the Ways and Means Committee, Rep. No. 179, 68th Cong., 1st Sess., p. 13.

"It appears best to provide generally that gain or loss is recognized from all exchanges and then except specifically and in definite terms those cases of exchange in which it is not desired to tax the gain or allow the loss. *This results in definiteness and accuracy and enables a tax-payer to determine prior to the consummation of a given transaction the tax liability that will result therefrom.*" [1] (Italics Supplied)

Again, in regard to the new paragraph (3) mentioned in the foregoing quotation from the Senate report, the Ways and Means Committee said:

"The statute should contain a definite rule on this question." [2]

As to the desire to disallow losses which otherwise would have been deductible, in reporting the 1921 provisions the Senate Finance Committee said the new provisions would considerably increase the revenue—

"by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges." [3]

It was therefore provided, first: that no gain should be recognized in the exchange of property solely for stock or securities in the transferee corporation; and second: that if the property received in exchange should also include other property or money (in addition to stock or securities), the gain should be recognized only to the extent that such other property or money was not distributed in pursuance of the plan of reorganization.

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1 Rep. No. 179, 68th Cong., 1st Sess., p. 13. See also the views of the Democratic Minority members of the Committee, at p. 77 of this report; the minority said—"We believe the law should be made definite and specific so every taxpayer will know under the law his rights and will not be required to have his tax adjudicated upon the discretion of the Treasury officials." See also Senate Finance Committee, Rep. No. 398, 68th Cong., 1st Sess., p. 14.

2 *Ibid.*, at p. 13.

3 Rep. No. 275, 67th Cong., 1st Sess., pp. 11-12. See also Ways and Means Committee, Rep. No. 350, 67th Cong., 1st Sess., p. 10.

In corporate mergers and reorganizations, the assumption of liabilities and the payment of debts is a very usual feature. The real value which the grantor corporation owns is the *equity* in its corporate property, i. e., the value of its assets after the debts have been paid or provision made therefor; and that equity is what the grantee acquires in a corporate reorganization. The disposition of the liabilities of the grantor corporation is the means by which it is enabled to acquire title to the grantor's property, free from the claims of creditors. The principal purpose and object of the negotiations leading up to the plan of reorganization is to reach an agreement or establish a basis as to the price to be paid for the *net* value of the stock or property to be transferred. When this has been done, it is largely a matter of legal detail and selection of mechanics as to the method by which the debts are paid. The more frequent ways in which this is done are:

1) The transferee may pay the transferor only the net worth of the assets and assume the liabilities (as was done in *U. S. v. Hendler,* supra, and in some of the other cases hereinafter cited);

2) The transferor, before the actual transfer, may pay its own debts;

3) The transferee may pay the transferor the gross value of its assets but require the liabilities to be paid by it later from the cash received from the transferee; or,

4) The transferor may require its stockholders to pay the corporate debts (as in this case).

The financial result to the transferor is exactly the same in all four cases, and the tax result should be the same in all four cases. Otherwise confusion and uncertainty arise in the operation of the reorganization provisions of the income tax law, in that the taxpayer can never be certain

whether, notwithstanding compliance with the statute, he may be held to have rendered himself liable to tax by selecting the wrong method of compliance.

There are numerous decisions where the transferee corporation has assumed liabilities of the transferor and where reorganizations involving this feature were held to be nontaxable without discussion of the point: *Coleman v. Commissioner,* 81 F. (2d) 455, 456; *G. & K. Mfg. Co. v. Commissioner,* 76 F. (2d) 454 (C. C. A. 4); reversed 296 U. S. 389, and remanded to the Board of Tax Appeals; *Starr v. Commissioner,* 82 F. (2d) 964, (C. C. A. 4); certiorari denied, 298 U. S. 680; *Watts v. Commissioner,* 75 F. (2d) 981 (C. C. A. 2), affirmed 296 U. S. 387; *Tulsa Oxygen Co. v. Commissioner,* 18 B. T. A. 1283; *Frank Keel,* 31 B. T. A. 212; *National Pipe & Foundry Co. v. Commissioner,* 19 B. T. A. 242; and in the *Hendler* case (supra), the Circuit Court of Appeals for the Fourth Circuit directly decides the point and expressly disagrees with the opinion of the Court below in the instant case, insofar as it is at variance with the views expressed in the opinion in the *Hendler* case.

As said above, the ultimate financial effect upon the corporation in the cases last cited (where the transferee corporation assumed the indebtedness) is precisely the same as in the present case (where the stockholders assumed it). If the decision of the Court below is not reversed, the tax result will be different and taxability made to depend entirely on the machinery selected, rather than upon compliance or non-compliance with the statute,—a result which is not only not in harmony with the avowed purpose of the Act, but which wholly disregards the plain wording of the statute.

The price paid for the transferor's assets by the transferee includes both the value which passes to the transferor or its stockholders and that which passes to its creditors;

and the entire profit will be recognized when, upon the ultimate sale or liquidation of the assets actually received by the corporation or its stockholders, a comparison is made between that which was originally put into the venture and that which has been finally taken out, as the Court says in *U. S. v. Hendler,* supra. Further that Court says:

> "Now it seems to us, bearing in mind the general purpose of the statute, that it was not the intention of Congress to recognize for immediate taxation the gain derived in a corporate reorganization to the extent it should consist of an assumption of the debts of the corporate grantor. Such an assumption is undoubtedly an asset of value and may fairly be called property in the broad sense; but the money spent in the performance of the promise passes to creditors and does not come into the possession of the debtor corporation or its stockholders. It reduces the debts and therefore frees the assets from the claims of creditors so that they may be lawfully distributed amongst the stockholders or otherwise disposed of; but it does not increase in their hands the assets whose liquidation brings about the actual enjoyment of the realized profit. Therefore the recognition of the gain, to the extent of the amount of the debt assumed, would not serve the statutory purpose, but on the contrary would tend to defeat it. It is a matter of common knowledge that a promise by the grantee to assume the debts of the grantor corporation is a customary incident of reorganization agreements, and where the transaction yields a profit to the grantor, taxable gain up to the amount of the assumed debt would accrue in the current year if the present contention of the Commissioner is correct, whether or not at that time the corporation or its stockholders had actually realized the profit in the transaction."

As appears in "Statement of Changes in the Revenue Act of 1921 by the Treasury Department and the Reasons Therefor," prepared for the use of the Ways and Means

Committee by A. W. Gregg, Special Assistant Secretary of the Treasury (see Appendix), Sec. 112 (d) was included in the law in order that the tax results in the case of acquisition of *stock* of a transferor corporation, and in the case of acquisition of *properties* of the transferor corporation, should be the same, where there is a statutory reorganization. It was therefore provided that where the corporation was a mere conduit, as here, for passing the proceeds of the sale to the ultimate owners, no recognizable gain should be deemed to accrue to the corporation.

To illustrate: If the reorganization here had been consummated by the Grand Union's acquisition of the *stock* of the petitioner from its stockholders, and as a part of that transaction the petitioner's stockholders had assumed certain liabilities of the petitioner which the acquiring corporation did not wish to assume, there would be no question but that no taxable gain could be deemed to occur to the petitioner. However, instead of handling the transaction in that way, the parties effected the reorganization by means of an acquisition by the Grand Union Company of the *properties* of petitioner. In connection with the acquisition of the properties, it was considered desirable by the parties, in order to carry out the plan and eliminate the necessity of selling part of the Grand Union stock, that the stockholders of the petitioner should assume certain liabilities of the petitioner. Exactly the same business result was effected as would have been the case had the Grand Union Company acquired the stock of the petitioner, instead of its assets.

If the decision of the Court below is correct, the tax result cannot be the same in cases of stock acquisition as in cases of property acquisition; and if the results are not the same in the two types of reorganization, the intention of Congress is not given effect.

If the Grand Union Company had assumed and paid the liabilities of the petitioner and had given the latter only $320,370.79 instead of $426,842.52, the result to the petitioner would be exactly the same as it finally was. But, as above stated, the Circuit Court of Appeals of the Fourth Circuit in *U. S. v. Hendler*, supra, has held that the assumption or payment of liabilities of the transferee corporation is not "other property or money" within the meaning of Sec. 112 (d), and accordingly the petitioner would not in such case be liable for tax on the amount of the indebtedness assumed. In other words, that Court rightly refused to view the matter as though the transferor had constructively received the amount of the debts which it did not distribute.

Moreover, if the view that assumption of indebtedness is the equivalent of cash should prevail, then the acquisition by one corporation of substantially all the properties of another in return for voting stock plus the assumption of liabilities of the transferring corporation, would not be a reorganization within the statutory definition, since the acquiring corporation would not give "solely" its voting stock in return for the assets. Any such result, we submit, would be unsound and out of harmony with the purpose of the reorganization provisions and would be out of harmony with many of the decided cases, including the most recent decision of the Circuit Court of Appeals for the Fourth Circuit, in the *Hendler* case.

So here, where the result to the transferring corporation was precisely the same as in the example last above cited, consistency demands a similar tax result. The petitioner here should not be penalized for choosing one method of compliance with the statute in preference to another.

The Court below in substance has held, and the respondent asks this Court to hold, that since the financial

result of the transaction to the petitioner was the same as though the latter had first paid its debts and then distributed the balance of the cash, the petitioner should be taxed on that basis. If this Court is to disregard what was actually done and base its holding on the *effect* of what was done, then it would be as proper and logical to say that since the effect or financial result of what was done was precisely the same as though the Grand Union Company (the transferee) had assumed and paid the petitioner's debts, and that since the latter arrangement would not have resulted in recognizable gain to the petitioner (*U. S. v. Hendler*, supra), the tax effect should be the same where the stockholders of the transferor paid the debts (as in the instant case). In other words, if the tax is to be determined by the *effect* of what was done, there is no more reason to favor one process of arriving at that effect more than the other.

It is not a sufficient answer to say that in this case the tax must be imposed, otherwise a gain will escape taxation. The net gain to the corporation is not evidenced by money used to pay corporate debts, but by what it *retains* or *fails* to *distribute* to its stockholders; and when the money is distributed, it becomes ultimately liable to proper taxation on gain actually realized. The intent and effect of the statute, therefore, is to postpone rather than to exempt from taxation.

To support the contention of the petitioner, it is not necessary to establish that the kind of distribution referred to in the statute includes a distribution to creditors, as well as to shareholders, although there are sound arguments to support this contention, and many eminent tax authorities favor this view, as, for example, *Montgomery Federal Tax Handbook*, 1936-1937, p. 218; *Paul & Mertons Law of Federal Income Taxation*, Vol. 2, Secs. 17, 102; *Miller, Reorganizations and other Exchanges in Income Taxation*, Sec. 134.

In this connection, the discussion of the lower Court in the *Hendler* case, 17 Fed. Supp. 558, is most persuasive, particularly the following language:

> "Two thoughts are clearly expressed in section 112 (d). One is that money or property received by the corporation and distributed in pursuance of the plan is not taxable to the corporation; the other is that money or other property so received and not so distributed, is taxable. Here the antithesis seems to be on distribution or retention by the corporation, and not distribution to stockholders or creditors. A third situation (the one with which we are here dealing) must be determined by a construction of the word 'distribute' as used in the statute. Does it necessarily cover only a distribution *to stockholders?* The statute does not so say and the construction contended for by the defendant reads into the statute words ('to the stockholders') which do not expressly appear therein; and in so doing reads out of the statute (or at least gives little significance to) the phrase 'in pursuance of the plan of reorganization.' The construction must be within and not without the words of the statute, and should if possible be consistent with the purpose of the enactment.
>
> * * * * *
>
> "There is no lexicological difficulty involved in including creditors within the scope of 'distribute' as used in the section under consideration. It might possibly be considered inapt to use the word if the distribution were limited to creditors only, because 'distribute to creditors' is such a familiar phrase in bankruptcy and insolvency, where it most often implies something less than payment in full. But there is no linguistic infelicity in the phrase 'distribute in pursuance of the plan of reorganization *among creditors and stockholders,*' because what is implied is a division of the whole fund between two classes, in accordance with

their respective rights. Indeed it would be difficult to select a more appropriate word than 'distribute' in this connection. (Cf. Baar & Morris, Hidden Taxes in Corporate Reorganizations, supra, p. 266.)

"Counsel for the defendant points out that in other related sections of the statute (112 (g) and 115) Congress has expressly limited 'distribution' as there used to stockholders; but this sign post for construction at best points two ways, because in those sections the words 'to stockholders' were imperatively required by the subject matter, which related to the taxation of the individual stockholders, while the section now being considered (112 (d)) relates to the corporation itself, as distinct from its stockholders, and in this connection the word distribute was not followed by the words 'to stockholders.' By contrast its omission in this section may be regarded as significant. Of course, to be nontaxable, the money must have been distributed in accordance with the plan of reorganization. We are not considering a situation where money is received and retained by a corporation for its general corporate purposes.

* * * * *

"I conclude, therefore, that money received by the corporation, and applied in pursuance of the plan of reorganization to the payment of debts is not to be treated as a taxable gain to the corporation."

In the Court below, the respondent relied upon *West Texas Refining and Developing Co. v. Commissioner*, 68 F. (2d) 77, as holding that "the 'distribution' referred to by the statute is a distribution to stockholders, and not to creditors of the corporation." In that case it was briefly stated by the Court that in a reorganization, money received by a corporation which is used to pay debts and not distributed to stockholders, is taxable, as otherwise a realized gain

would escape taxation. There was no further discussion, probably because on the main point of the case the transaction was held not to be a reorganization, but a sale. The decision was in 1933, prior to the decisions of this Court in *Helvering v. Minnesota Tea Co.*, 296 U. S. 378; *Helvering v. Watts*, 296 U. S. 387; *G. & K. Mfg. Co. v. Helvering*, 296 U. S. 389, and *Nelson Co. v. Helvering*, 296 U. S. 374. But even though it should ultimately be held that a direct payment by a corporation to its creditors of cash received in a statutory reorganization is not a "distribution" within the intendment of the law, such a proposition, as said by the Board of Tax Appeals in its opinion in the present case (R. 17), "does not carry the corollary that the shareholders' promise to discharge the corporation's current debts had the same effect and changes the distribution made to them into a discharge by the corporation of its debts, converting, so to speak, the actual distribution *pro tanto* into a constructive nondistribution."

CONCLUSION

Petitioner accordingly respectfully submits that it exchanged all its property for stock of a corporation, a party to the reorganization, plus money; that it immediately distributed all the money in pursuance of a plan of reorganization; that both the wording and the spirit of the statutes

and regulations have been complied with, and that the petitioner realized no taxable gain under the statute.

The decision of the Court below, therefore, should be reversed.

Respectfully submitted,

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APPENDIX

Statutes Involved.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. *Determination of Amount of Gain or Loss.*

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. *Recognition of Gain or Loss.*

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the

plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

* * * * *

(d) *Same—Gain of Corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but—

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

Article 575 of Reg. 74 (1928 Act) provides in part:

> * * * If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to the reorganization, for stock or securities in another corporation, a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case, no loss from the exchange will be recognized. (See Sec. 112 (e).)

The provision in question first appeared in the Revenue Act of 1924, as to which the Ways and Means Committee (Rep. M. 179, 68 Cong. 1st Sess., p. 15) reported as follows:

> "There is no provision of the existing law which corresponds to subdivision (d) of the Bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization transfers its assets to another corporation a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss (sic) to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders, then the gain or loss (sic) is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized,

but if it retains all or any part of the proceeds with the result that the transaction is in substance a real sale, then all or part of the gain shall be recognized."

The provision was further explained in "Statement of the Changes in the Revenue Act of 1921 by the Treasury Department, and the Reasons Therefor," prepared for the use of the Ways and Means Committee, by A. W. Gregg, Special Assistant to the Secretary of the Treasury, printed in full in the New York Times for January 5, 1924:

"A corporation in connection with a reorganization may make distribution of its assets in one of three ways:

"It may transfer them to a new corporation in exchange for stock or cash; it may transfer them to the new corporation, the consideration being the payment by the new corporation of stock or cash to the stockholders of the old corporation; or the new corporation may buy with its stock and cash, from the stockholders of the old corporation, their stock, and then liquidate* the old corporation. If a corporation adopts the first method, its gain from the sale could be taxed. If it adopts the second method, the gain probably could be taxed on the theory of constructive receipt by the selling corporation. *If it adopts the third method there is no theory on which any gain to the old corporation could be taxed.*

"As a result of these considerations, subdivision (e) has been so drafted that *the tax liability on the selling corporation is the same, no matter which of the three methods set out above is adopted.* In other words, if the selling corporation is a mere conduit through which the consideration for the sale of the assets passes, or if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized, and

the same result is reached necessarily, as if the transaction were accomplished through the medium of a purchase by a new corporation of stock of the old corporation, followed by liquidation* of the old." (Italics ours.)

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* See the last paragraph in the opinion in *Helvering v. Minnesota Tea Co.*, 296 U. S. 378, where it is held that dissolution is not necessary.